

RUSSELL COUNTY SCHOOL DISTRICT

BASIC FINANCIAL STATEMENTS,
SUPPLEMENTARY INFORMATION,
AND INDEPENDENT AUDITOR'S REPORTS

Year Ended June 30, 2003

RUSSELL COUNTY SCHOOL DISTRICT

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INDEPENDENT AUDITOR'S REPORT

Members of the Board of Education
Russell County School District
Jamestown, Kentucky

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Russell County School District as of and for the year ended June 30, 2003, which collectively comprise the District's basic financial statements, as listed in the accompanying table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and the audit requirements prescribed by the Kentucky State Committee for School District Audits in Appendix I of the Independent Auditor's Contract - General Audit Requirements, Appendix II of the Independent Auditor's Contract - State Audit Requirements, and Appendix III of the Independent Auditor's Contract - Electronic Submission. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note B the District adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*; and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, as of July 1, 2002.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the District as of June 30, 2003, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Management's Discussion and Analysis on pages 3 through 9, and the Budgetary Comparison Information on pages 39 through 40 are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated August 22, 2003, on our consideration of Russell County School District's internal control over financial reporting and/or tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Russell County School District's basic financial statements. The combining financial statements as listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Also, the accompanying Schedule of Expenditures of Federal Awards on pages 45 through 46 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, and is also not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Certified Public Accountants
August 22, 2003

**RUSSELL COUNTY SCHOOL DISTRICT – JAMESTOWN, KY
MANAGEMENT’S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED JUNE 30, 2003**

The discussion and analysis of Russell County School District’s financial performance provides an overall review of the School District’s financial activities for the fiscal year ended June 30, 2003. The intent of this discussion and analysis is to review the School District’s financial performance as a whole; readers should also review the financial statements and notes to the financial statements to enhance their understanding of the School District’s financial performance.

The Management’s Discussion and Analysis (MD&A) is an element of the new reporting model adopted by the Governmental Accounting Standards Board (GASB) in the Statement No. 34 *Basic Financial Statements-and Management’s Discussion and Analysis-for State and Local governments* issued in June 1999.

FINANCIAL HIGHLIGHTS

- The beginning cash balance for the District was \$3.9 million.
- Following the completion of the District long-range plan for facilities, there is a focus on renovation of facilities and additional educational space.
- The board initiated the construction of a new Jamestown Elementary School in fiscal 2003 and issued bonds for the project in fiscal 2004.
- Due to the decline of interest rates, interest income fell \$49,000; that is a 21.5 percent decrease.
- During fiscal 2003, the District felt little impact of the declining economy other than the reduction in interest income. However, we anticipate flat to falling revenue by fiscal 2004.
- The General Fund had \$15.5 million in revenue, which primarily consisted of the state program (SEEK), property, utilities, and motor vehicle taxes. Excluding inter-fund transfers, there were \$16. million in General Fund expenditures.
- Bonds are issued as the District renovates facilities consistent with a long-range facilities plan that is established with community input and in keeping with Kentucky Department of Education (KDE) stringent compliance regulations. The District’s total debt decreased by \$575,000 during the current fiscal year.

USING THIS ANNUAL REPORT

This discussion and analysis is intended to serve as an introduction to the District’s basic financial statements. The District’s basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide financial statements. The government-wide financial statements are designed to provide readers with a broad overview of the District’s finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the District’s assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The statement of activities presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The government-wide financial statements outline functions of the District that are principally supported by property taxes and intergovernmental revenues (governmental activities). The governmental activities of the District include instruction, support services, operation and maintenance of plant, student transportation and operation of non-instructional services. Fixed assets and related debt is also supported by taxes and intergovernmental revenues.

The government-wide financial statements can be found on pages 10 - 11 of this report.

Fund financial statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. This is a state mandated uniform system and chart of accounts for all Kentucky public school districts utilizing the MUNIS administrative software. The District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. All of the funds of the District can be divided into three categories: governmental, proprietary funds and fiduciary funds. The only fiduciary funds are agency funds for student education. The only proprietary funds are our food service and childcare operations. All other activities of the District are included in the governmental funds.

The basic governmental fund financial statements can be found on pages 12 - 19 of this report.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the financial statements can be found on pages 20 - 38 of this report.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$11 million as of June 30, 2003.

The largest portion of the District's net assets reflects its investment in capital assets (e.g., land and improvements, buildings and improvements, vehicles, furniture and equipment and construction in progress), less any related debt used to acquire those assets that is outstanding. The District uses these capital assets to provide services to its students; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The District's financial position is the product of several financial transactions including the net results of activities, the acquisition and payment of debt, the acquisition and disposal of capital assets, and the depreciation of capital assets.

**Net Assets for the period ending June 30, 2003
(Table 1)**

The current year's financial statements are dramatically different from past years as a result of implementing GASB 34. Attempting to compare this year's data with last year's would be misleading to the reader however the District looks forward to offering comparative data in the future.

	<u>Government Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
Current and Other Assets	\$ 4,362,614	\$ 143,643	\$ 4,506,257
Capital Assets	<u>19,152,731</u>	<u>1,026,821</u>	<u>20,179,552</u>
Total Assets	\$ 23,515,345	\$ 1,170,464	\$ 24,685,809
Long-term Debt	12,103,256		12,103,256
Other Liabilities	<u>1,385,538</u>	<u>5,792</u>	<u>1,391,330</u>
Total Liabilities	\$ 13,488,794	\$ 5,792	\$ 13,494,586
Net Assets			
Investment in capital assets (net of debt)	\$ 7,293,996	\$ 1,026,821	8,320,817
Restricted			
Unreserved Fund Balance	<u>2,732,555</u>	<u>137,851</u>	<u>2,870,406</u>
Total Net Assets	<u>\$ 10,026,551</u>	<u>\$ 1,164,672</u>	<u>\$ 11,191,223</u>

The following are significant current year transactions that have had an impact on the Statement of Net Assets.

The District implemented GASB 34 and recorded fixed assets and debt for the first time.

Comments on Budget Comparisons

- The District's total revenues for the fiscal year ended June 30, 2003, net of Interfund transfers, were \$22 million.
- General fund budget compared to actual revenue varied slightly from line item to line item with the ending actual balance being \$3 million more than budget or approximately 24%.
- The total cost of all programs and services was \$21 million net of debt service.
- General fund budget expenditures to actual varied significantly in Instruction, District Administrative Support, and Plant. Instruction expenditures were more than budget because the District did not budget on-behalf payments in accordance with Kentucky Department of Education instructions. District Administrative and Plant expenditures were less than budget because of the District's contingency budget and not having to spend funds for plant capital additions.

The following Table 2 presents a summary of changes in net assets for the fiscal year ended June 30, 2003.

	(Table 2)		
	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Totals</u>
Program Revenues:			
Charges for services	\$ 74,700	\$ 374,555	\$ 449,255
Operating grants	4,647,571	962,763	5,610,334
General revenues:			
Taxes	3,230,474		3,230,474
State Aid-Formula Grant	12,112,717		12,112,717
Investment Earnings	177,905	1,367	179,270
Gain (loss) on sale of assets	2,615		2,615
Total Revenues	\$ 20,245,980	\$ 1,338,685	\$21,584,665
Program Expenses:			
Instruction	\$12,238,360		\$12,238,360
Student support services	1,225,395		1,225,395
Instructional support	1,116,009		1,116,009
District administration	455,090		455,090
School administration	1,012,637		1,012,637
Business support	159,227		159,227
Plant operations	1,577,905		1,577,905
Student transportation	1,289,692		1,289,692
Central office support	213,185		213,185
Community support	368,714		368,714
Facility acquisition/construction	4,703		4,703
Interest on long-term debt	504,276		504,276
Food service		1,304,312	1,304,312
Childcare		59,397	59,397
Total Expenses	\$20,165,193	\$ 1,363,709	\$21,528,902
Increase (decrease) in net assets	\$ <u>80,787</u>	\$ <u>(25,024)</u>	\$ <u>55,763</u>

Governmental Activities

Instruction comprises 61% of governmental program expenses. Support services expenses make up 37% of government expenses. The remaining expense for interest and facility acquisition/construction accounts for the remaining 2% of total government expense.

The Statement of Activities shows the cost of program services and the charges for services and grants offsetting those services. Table 3 shows, for government activities, the total cost of services and the net cost of services. That is, it identifies the cost of these services supported by tax revenue and unrestricted State entitlements.

(Table 3)

	Governmental Activities Total Cost of Services 2003	Net Cost of Services 2003
Instruction	\$ 12,238,360	\$ 8,453,687
Support services	7,417,854	6,480,256
Facility acquisition/construction	4,703	4,703
Interest on long-term debt	<u>504,276</u>	<u>504,276</u>
Total Expenses	<u>\$ 20,165,193</u>	<u>\$ 15,442,922</u>

Business-Type Activities

The business-type activities are the food service operation and childcare operation. These programs had total revenues of \$1,338,685 and expenses of \$1,363,709 for fiscal year 2003. Of the revenues, \$374,555 was charges for services, \$962,763 was from State and Federal grants and \$1,367 was from investment earnings. Business activities receive no support from tax revenues. The School District will continue to monitor the charges and costs of this activity. If it becomes necessary, the School District will increase the charges for this activity.

The School District's Funds

Information about the School District's major funds starts on page 12. These funds are accounted for using the modified accrual basis of accounting. All governmental funds had total revenues and other financing sources of \$21,446,534 and expenditures and other financing uses of \$21,459,642. Net changes in fund balances for the year were most significant in General Fund (\$257,772), and Special Revenue Fund \$52,940.

The decrease in General Fund was due to a reduction in state funding. The increase in Special Revenue Fund was due to the transfer of a specific program (KETS) to this Fund.

General Fund-Budget Highlights

The School District's budget is prepared according to Kentucky law and is based on accounting for certain transactions on a basis of cash receipts, disbursements and encumbrances. The most significant budgeted fund is the General Fund. The State Department of Education requires a zero-based budget with any budgeted remaining fund balance shown as a contingency expense in the budget process.

For the General Fund revenues were budgeted at \$12,496,630 with actual amounts of \$15,486,488. Budgeted expenditures of \$16,123,777 compare with actual expenditures of \$15,962,494.

Capital Assets and Debt Administration

Capital Assets

At the end of fiscal year 2003 the School District had \$20,179,552 invested in land, buildings, equipment, construction in progress, and \$19,152,731 in governmental activities. Table 4 shows fiscal year 2003 balances.

(Table 4)
Capital Assets at June 30, 2003
(Net of Depreciation)

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Totals</u>
Land and land improvements	\$ 1,175,409	\$ -	\$ 1,175,409
Buildings and improvements	16,504,309	892,973	17,397,282
Technology	345,159		345,159
Vehicles	586,017		586,017
General equipment	333,037	133,848	466,885
Construction in progress	<u>208,800</u>	<u> </u>	<u>208,800</u>
Total	<u>\$ 19,152,731</u>	<u>\$ 1,026,821</u>	<u>\$ 20,179,552</u>

Construction began on a new Jamestown Elementary School. This unfinished project cost is in construction in progress at June 30, 2003.

Debt

At June 30, 2003, the School District had \$9,760,000 in bonds outstanding, of this amount \$2,330,372 is to be paid from the KSFCC funding provided by the State of Kentucky. A total of \$565,000 is due within one year.

District Challenges for the Future

Russell County School District's financial status has declined slightly in the last fiscal year. This decline was the result of several factors, including continued student growth without increased state funding due to the growth, a decrease in state funding, and various unfunded mandates. Because of these issues, long-term financial strategies will need to be implemented through the budgeting process.

The School District has experienced an annual growth in student enrollment of 25-58 students per year, for the last 3 years. The School District has prepared for an increase in enrollment by building new schools and renovating and adding to existing schools. These new facilities come with increased utility costs and additional personnel cost (both administrative and support staffs). These new buildings also have a cost for computers, library books, instructional materials, and other items that are primarily paid from the General Fund. These costs along with the need to maintain facilities in the next few years will create more challenges for the School District.

The costs associated with growth have in the past been offset due to increased student enrollment producing additional state funding, and continued increases in business and residential property subject to tax within the School District. Our property tax base continues to grow; however our School District, like all Kentucky School Districts, is limited to a 4% annual growth in property tax revenue on existing property.

Additional factors concerning our School District's financial status include the implementation of various unfunded mandates. Examples include the Flex Fund accounts (Professional Development, Safe Schools, Preschool, Textbooks and Extended School Services). State funding for these programs does not meet our needs as a District. Therefore, local generated funds will have to address these areas. Also, the uncertainty of state budgeted revenue projections may impact our funding as well as future mandated salary increases for all certified personnel. In addition, the full effect of No Child Left Behind (NCLB) has yet to be determined. Funding for this program is not equal to the mandates required by the Federal Government.

With careful planning and monitoring of our finances, Russell County Schools' goal is to continue to provide a quality education for our students and a secure financial future for the School District.

Contacting the School District's Financial Management

This financial report is designed to provide our citizens, taxpayers, and investors and creditors with a general overview of the School District's finances and to show the School District's accountability for the money it receives. If you have any question about this report or need additional information contact John Loy, 404 S. Main St., P.O. Box 440, Jamestown, Kentucky 42629.

BASIC FINANCIAL STATEMENTS

FUND FINANCIAL STATEMENTS

NOTES TO THE BASIC FINANCIAL STATEMENTS

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS

Year Ended June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Russell County Board of Education ("Board"), a five-member group, is the level of government, which has oversight responsibilities over all activities related to public elementary and secondary school education within the jurisdiction of Russell County Board of Education ("District"). The District receives funding from Local, State and Federal government sources and must comply with the commitment requirements of these funding source entities. However, the District is not included in any other governmental "reporting entity" as defined in Section 2100, Codification of Governmental Accounting and Financial Reporting Standards. Board members are elected by the public and have decision making authority, the power to designate management, the responsibility to develop policies, which may influence operations and primary accountability for fiscal matters. As allowed in Section P80 of GASB's Codification of Governmental Accounting and Financial Reporting Standards, the District has elected not to apply to its proprietary activities Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee of Accounting Procedure issued after November 30, 1989.

The District, for financial purposes, includes all of the funds and account groups relevant to the operation of the Russell County Board of Education. The financial statements presented herein do not include funds of groups and organizations, which although associated with the school system, have not originated within the Board itself such as Band Boosters, Parent-Teacher Associations, etc.

The financial statements of the District include those of separately administered organizations that are controlled by or dependent on the Board. Control or dependence is determined on the basis of budget adoption, funding and appointment of the respective governing board.

Based on the foregoing criteria, the financial statements of the following organization are included in the accompanying financial statements:

Russell County Board of Education Finance Corporation – In a prior year the Board of Education resolved to authorize the establishment of the Russell County School District Finance Corporation (a non-profit, non-stock, public and charitable corporation organized under the School Bond Act and KRS 273 and KRS Section 58.180) (the "Corporation") as an agency for the District for financing the costs of school building facilities. The members of the Board also comprise the Corporation's Board of Directors. The Corporation is blended into the District's financial statements.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Basis of Presentation

The District's basic financial statements consist of government-wide statements, including a statement of net assets and a statement of activities, and fund financial statements, which provide a more detailed level of financial information.

Government-wide Financial Statements – The statement of net assets and the statement of activities display information about the District as a whole. These statements include the financial activities of the primary government, except for fiduciary funds. The statements distinguish between those activities of the District that are governmental and those that are considered business-type activities.

The government-wide statements are prepared using the economic resources measurement focus. This is the same approach used in the preparation of the proprietary fund financial statements but differs from the manner in which governmental fund financial statements are prepared. Governmental fund financial statements therefore include reconciliation with brief explanations to better identify the relationship between the government-wide statements and the statements for governmental funds.

The statement of net assets presents the financial condition of the governmental and business-type activities of the District at year-end. The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the District and for each function or program of the District's governmental activities. Direct expenses are those that are specifically associated with a service, program or department and are therefore clearly identifiable to a particular function. Program revenues include charges paid by the recipient of the goods or services offered by the program and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues that are not classified as program revenues are presented as general revenues of the District, with certain limited exceptions. The comparison of direct expenses with program revenues identifies the extent to which each business segment or governmental function is self-financing or draws from the general revenues of the District.

Fund Financial Statements – Fund financial statements report detailed information about the District. The focus of governmental and enterprise fund financial statements is on major funds rather than reporting funds by type. Each major fund is presented in a separate column. Nonmajor funds are aggregated and presented in a single column. Fiduciary funds are reported by fund type.

The accounting and reporting treatment applied to a fund is determined by its measurement focus. All governmental fund types are accounted for using a flow of current financial resources measurement focus. The financial statements for governmental funds are a balance sheet, which generally includes only current assets and current liabilities, and a statement of revenues, expenditures and changes in fund balances, which reports on the changes in fund balances. Proprietary funds are reported using the economic resources measurement focus. All assets and liabilities associated with the operation of these funds are included on the statement of net assets. The statement of changes in fund net assets presents increases and decreases in net total assets. The statement of cash flows provides information about how the District finances and meets the cash flow needs of its proprietary activities. Fiduciary funds are also reported using the economic resources measurement focus.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

The District has the following funds:

I. Governmental Fund Types

- (A) The General Fund is the main operating fund of the Board. It accounts for financial resources used for general types of operations. This is a budgeted fund, and any fund balances are considered as resources available for use. This is a major fund of the District.
- (B) The Special Revenue Fund accounts for proceeds of specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to disbursements for specified purposes. It includes federal financial programs where unused balances are returned to the grantor at the close of the specified project periods as well as the state grant programs. Project accounting is employed to maintain integrity for the various sources of funds. The separate projects of federally-funded grant programs are identified in the Schedule of Expenditures of Federal Awards included in this report on pages 45 through 46. This is a major fund of the District.
- (C) Capital Project Funds are used to account for financial resources to be used for the acquisition or construction of major capital facilities and equipment (other than those financed by Proprietary Fund).
 - 1. The Support Education Excellence in Kentucky (SEEK) Capital Outlay Fund receives those funds designated by the state as Capital Outlay Funds and is restricted for use in financing projects identified in the District's facility plan.
 - 2. The Facility Support Program of Kentucky (FSPK) accounts for funds generated by the building tax levy required to participate in the School Facilities Construction Commission's construction funding and state matching funds, where applicable. Funds may be used for projects identified in the District's facility plan.
 - 3. The Technology Fund accounts for the Kentucky Education Technology System (KETS) allocation and local district matching funds restricted for the purchase of technology consistent with the District's approved technology plan. The fund activity was transferred to the Special Revenue Fund during the fiscal year.
 - 4. The Construction Fund accounts for proceeds from sales of bonds and other revenues to be used for authorized construction. This is a major fund of the District.
- (D) The Debt Service Funds are used to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest and related cost; and for the payment of interest on general obligation notes payable, as required by Kentucky Law.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – CONTINUED

II. Proprietary Fund Types (Enterprise Fund)

- A. The Food Service Fund is used to account for school food service activities, including the National School Lunch and Breakfast Programs, which are conducted in cooperation with the U.S. Department of Agriculture (USDA). Amounts have been recorded for in-kind contribution of commodities from the USDA. The Food Service Fund is a major fund.
- B. The FRC Childcare Fund is used to account for the District's childcare operation.

III. Fiduciary Fund Type (Agency Fund)

- A. The Agency fund accounts for activities of student groups and other types of activities requiring clearing accounts. These funds are accounted for in accordance with the Uniform Program of Accounting for School Activity Funds. Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations.

Basis of Accounting

Basis of accounting determines when transactions are recorded in the financial records and reported on the financial statements. Government-wide financial statements are prepared using the accrual basis of accounting. Governmental funds use the modified accrual basis of accounting. Proprietary and fiduciary funds also use the accrual basis of accounting.

Revenues – Exchange and Non-exchange Transactions – Revenues resulting from exchange transactions, in which each party receives essentially equal value, is recorded on the accrual basis when the exchange takes place. On a modified accrual basis, revenues are recorded in the fiscal year in which the resources are measurable and available. Available means that the resources will be collected within the current fiscal year or are expected to be collected soon enough thereafter to be used to pay liabilities of the current fiscal year. For the District, available means expected to be received within sixty days of the fiscal year-end.

Nonexchange transactions, in which the District receives value without directly giving equal value in return, include property taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year when the resources are required to be used or the fiscal year when use is first permitted, matching requirements, in which the District must provide local resources to be used for a specified purpose, and expenditure requirements, in which the resources are provided to the District on a reimbursement basis. On a modified accrual basis, revenues from nonexchange transactions must also be available before it can be recognized.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Basis of Accounting - continued

Deferred Revenue – Deferred revenue arises when assets are recognized before revenue recognition criteria have been satisfied.

Grants and entitlements received before the eligibility requirements are met are recorded as deferred revenue.

Expenses/Expenditures – On the accrual basis of accounting, expenses are recognized at the time they are incurred. The fair value of donated commodities used during the year is reported in the statement of revenues, expenses, and changes in net assets as an expense with a like amount reported as donated commodities revenue. Unused donated commodities are reported as deferred revenue.

The measurement focus of governmental fund accounting is on decreases in net financial resources (expenditures) rather than expenses. Expenditures are generally recognized in the accounting period in which the related fund liability is incurred, if measurable. Allocations of cost, such as depreciation, are not recognized in governmental funds.

Property Taxes

Property Tax Revenues – Property taxes are normally levied each September on the assessed value listed as of the prior January 1, for all real and personal property in the county. The billings are considered due upon receipt by the taxpayer; however, the actual date is based on a period ending 30 days after the tax bill mailing. Property taxes collected are recorded as revenues in the fiscal year for which they were levied. All taxes collected are initially deposited into the General Fund and then transferred to the appropriate fund. The usual collection date is the period from November 1 through December 31. Property tax bills paid prior to December 1 received a two percent discount. Property taxes received after December 31, are considered to be delinquent and the County Attorney can file a lien against the property.

The property tax rates assessed for the year ended June 30, 2003, to finance operations were \$.388 per \$100 valuation for real property, \$.434 per \$100 valuation for business personal property and \$.525 per \$100 valuation for motor vehicles.

The District levies a utility gross receipts license tax in the amount of 3% of the gross receipts derived from the furnishings, within the county, of telephonic and telegraphic communications services, cablevision services, electric power, water, and natural, artificial and mixed gas.

Capital Assets

General capital assets are those assets not specifically related to activities reported in the proprietary funds. These assets generally result from expenditures in the governmental funds. These assets are reported in the governmental activities column of the government-wide statement of net assets but are not reported in the fund financial statements. Capital assets utilized by the proprietary funds are reported both in the business-type activities column of the government-wide statement of net assets and in the respective funds.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

All capital assets are capitalized at cost (or estimated historical cost) and updated for additions and retirements during the year. Donated fixed assets are recorded at their fair market values as of the date received. The District maintains a capitalization threshold of one thousand dollars with the exception of computers, digital cameras and real property for which there is no threshold. The District does not possess any infrastructure. Improvements are capitalized; the cost of, normal maintenance and repairs that do not add to the value of the asset or materially extend an assets life are not.

All reported capital assets are depreciated. Improvements are depreciated over the remaining useful lives of the related capital assets. Depreciation is computed using the straight-line method over the following useful lives for both general capital assets and proprietary fund assets:

<u>Description</u>	<u>Governmental Activities Estimated Lives</u>
Land improvements	20 years
Buildings and improvements	25-50 years
Technology equipment	5 years
Vehicles	5-10 years
General equipment	5-15 years
Food service equipment	5-12 years

Interfund Balances

On fund financial statements, receivables and payables resulting from short-term interfund loans are classified as "interfund receivables/payables". These amounts are eliminated in the governmental and business-type activities columns of the statements of net assets, except for the net residual amounts due between governmental and business-type activities, which are presented as internal balances.

Budgetary Process

Budgetary Basis of Accounting: The District's budgetary process accounts for certain transactions on a basis other than Generally Accepted Accounting Principles (GAAP). The major differences between the budgetary basis and the GAAP basis are:

Revenues are recorded when received in cash (budgetary) as opposed to when susceptible to accrual (GAAP).

Expenditures are recorded when paid in cash (budgetary) as opposed to when susceptible to accrual (GAAP).

Once the budget is approved, it can be amended. Amendments are presented to the Board at their regular meetings. All budget appropriations lapse at year-end.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

Encumbrances

Encumbrances are not liabilities and, therefore, are not reported as expenditures until receipt of material or service. For budgetary purposes, appropriations lapse at fiscal year-end and outstanding encumbrances at year-end are reappropriated in the next year. A reservation of fund balance equal to outstanding encumbrances at year-end is provided for at June 30, 2003.

Cash and Cash Equivalents

The District considers demand deposits, money market funds, and other investments with an original maturity of 90 days or less, to be cash equivalents.

Inventories

On government-wide financial statements inventories are stated at cost and are expensed when used.

On fund financial statements inventories are stated at cost. The cost of inventory items is recorded as an expenditure in the governmental fund types when purchased.

The food service fund uses the specific identification method and the general fund uses the first-in, first-out method.

Prepaid Assets

Payments made that will benefit periods beyond June 30, 2003, are recorded as prepaid items using the consumption method. A current asset for the prepaid amount is recorded at the time of the purchase and an expenditure/expense is reported in the year in which services are consumed.

Receivables

The District recognizes revenues as receivable when they are measurable and receipt is probable. Concentration of credit risk with respect to the receivables from federal and state governments is limited due to the historical stability of those institutions.

Accrued Liabilities and Long-Term Obligations

All payables accrued liabilities and long-term obligations are reported in the government-wide financial statements, and all payables, accrued liabilities and long-term obligations payable from proprietary funds are reported on the proprietary fund financial statements.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - CONTINUED

In general, payables and accrued liabilities that will be paid from governmental funds are reported on the governmental fund financial statements regardless of whether they will be liquidated with current resources. However, claims and judgments, the noncurrent portion of capital leases, accumulated sick leave, contractually required pension contributions and special termination benefits that will be paid from governmental funds are reported as a liability in the fund financial statements only to the extent that they will be paid with current, expendable, available financial resources. In general, payments made within sixty days after year-end are considered to have been made with current available financial resources. Bonds and other long-term obligations that will be paid from governmental funds are not recognized as a liability in the fund financial statements until due.

Fund Balance Reserves

The District reserves those portions of fund equity which are legally segregated for a specific future use or which do not represent available expendable resources and therefore are not available for appropriation or expenditure. Unreserved fund balance indicates that portion of fund equity, which is available for appropriation in future periods. Fund equity reserves have been established for inventories and fixed assets.

Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the School District or through external restrictions imposed by creditors, grantors or laws or regulations of other governments.

Operating Revenues and Expenses

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary funds. For the School District, those revenues are primarily charges for meals provided by the various schools and for childcare services provided.

Contributions of Capital

Contributions of capital in proprietary fund financial statements arise from outside contributions of fixed assets, or from grants or outside contributions of resources restricted to capital acquisition and construction.

Interfund Activity

Exchange transactions between funds are reported as revenues in the seller funds and as expenditures/expenses in the purchaser funds. Flows of cash or goods from one fund to another without a requirement for repayment are reported as interfund transfers. Interfund transfers are reported as other financing sources/uses in governmental funds and after nonoperating revenues/expenses in proprietary funds. Repayments from funds responsible for particular expenditures/expenses to the funds that initially paid for them are not presented on the financial statements.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE B – CHANGES IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF FUND BALANCE

For the fiscal year ended June 30, 2003, the District implemented GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments and Interpretation No. 6. Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.

GASB 34 creates new basic financial statements for reporting on the School District’s financial activities. The financial statements now include government-wide financial statements prepared on an accrual basis of accounting and fund financial statements which present information for individual major funds rather than by fund type. Nonmajor funds are presented in total in one column.

The government-wide financial statements split the District’s programs between business-type and governmental activities. The beginning net asset amount for governmental programs reflects the change in fund balance for governmental funds at June 30, 2002, caused by the conversion to the accrual basis of accounting.

The School District made several changes in accounting principles during the year. For governmental activities, they began recording the current portion of the accumulated sick leave liability, removed long-term investments not to be used for current expenditures, and began accounting for technology fund revenues in the special revenue fund. These changes bring the District’s funds into compliance with the fund classifications and requirements of GASB 34.

Restatement of Fund Balance – The restatement for the above changes and the transition from governmental fund balance to net assets of the governmental activities is presented below:

	<u>General</u>	<u>Special Revenue</u>	<u>Construction</u>	<u>Nonmajor</u>	<u>Total</u>
Fund Balance June 30, 2002	\$ 3,627,148	\$ 197,702	\$ -	\$ 86,373	\$ 3,911,223
GASB 34 Adjustments:					
Capital Assets – Net of Depreciation					19,555,687
Long-Term Liabilities					(12,487,944)
Accumulated sick leave - long-term portion					(909,848)
Accrued interest payable					<u>(123,354)</u>
Governmental Activities Net Assets, June 30, 2002					<u>\$ 9,945,764</u>

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE B – CHANGES IN ACCOUNTING PRINCIPLES AND RESTATEMENT OF FUND BALANCE – CONTINUED

The District had a fixed asset inventory taken to comply with GASB 34. This inventory revealed the existence of proprietary fixed assets that have not previously been recorded on the books. Changes as a result of the GASB 34 implementation are as follows:

	<u>Food Service</u>	<u>FRC- Childcare</u>	<u>Total</u>
Net Assets, June 30, 2002	\$ 282,621	\$ 13,883	\$ 296,504
Additional fixed assets	<u>893,192</u>	<u>-</u>	<u>893,192</u>
Adjusted Net Assets, June 30, 2002	<u>\$ 1,175,813</u>	<u>\$ 13,883</u>	<u>\$ 1,189,696</u>

As proprietary funds are already on the accrual basis, no adjustments are necessary for the Statement of Net Assets.

NOTE C – ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the District's management to make estimates and assumptions that affect reported amounts of assets, liabilities, fund balances, and disclosure of contingent assets and liabilities at the date of the general purpose financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE D – CASH AND CASH EQUIVALENTS

At year-end, the carrying amount of the District's total cash and cash equivalents was \$5,807,083. Included in total cash are Certificates of Deposit totaling \$1,007,836. Of the total cash balance, \$200,000 was covered by Federal Depository Insurance, with the remainder covered by collateral agreements and collateral held by the pledging banks' trust departments in the District's name. Cash equivalents are funds temporarily invested in securities with a maturity of 90 days or less.

Cash and cash equivalents at June 30, 2003 consisted of the following:

	<u>Bank Balance</u>	<u>Book Balance</u>
First National Bank	\$ 3,182,590	\$ 3,180,928
Bank of Jamestown	<u>2,624,493</u>	<u>711,197</u>
	<u>\$ 5,807,083</u>	<u>\$ 3,892,125</u>

Breakdown per financial statements:

Governmental funds	\$ 3,576,297
Business-type funds	122,541
Agency funds	<u>193,287</u>
	<u>\$ 3,892,125</u>

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE E - CAPITAL ASSETS

Capital asset activity for the fiscal year ended June 30, 2003, was as follows:

<u>Governmental Activities</u>	<u>Balance July 1, 2002</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2003</u>
Land	\$ 1,865,392	\$ 28,848	\$ -	\$ 1,894,240
Buildings and improvements	22,349,596	61,225		22,410,821
Technology equipment	951,512	190,113		1,141,625
Vehicles	2,907,863	10,450	(19,106)	2,899,207
General equipment	603,449	18,807		622,256
Construction in progress		208,800		208,800
 Totals at historical cost	 28,677,812	 518,243	 (19,106)	 29,176,949
Accumulated depreciation:				
Land improvements	651,124	67,707		718,831
Buildings and improvements	5,427,865	478,647		5,906,512
Technology equipment	620,611	175,855	(19,106)	796,466
Vehicles	2,183,961	148,335		2,313,190
General equipment	238,564	50,655		289,219
Total accumulated depreciation	<u>9,122,125</u>	<u>921,199</u>	<u>(19,106)</u>	<u>10,024,218</u>
 Government Activities Capital Assets - Net	 <u>\$ 19,555,687</u>	 <u>\$ (402,956)</u>	 <u>\$ -</u>	 <u>\$ 19,152,731</u>
 <u>Business-Type Activities</u>				
Buildings and improvements	1,118,055			1,118,055
Food service equipment	343,087	13,873		356,960
 Totals at historical cost	 1,461,142	 13,873		 1,475,015
Accumulated depreciation:				
Buildings and improvements	204,140	20,942		225,082
Food service equipment	192,944	30,168		223,112
Total accumulated depreciation	<u>397,084</u>	<u>51,110</u>		<u>448,194</u>
 Government Activities Capital Assets - Net	 <u>\$ 1,064,058</u>	 <u>\$ (37,237)</u>	 <u>\$ -</u>	 <u>\$ 1,026,821</u>
Depreciation was charged to governmental functions as follows:				
Instruction	\$ 723,559			
Instructional staff	320			
District administration	13,317			
School administration	1,578			
Plant	19,325			
Transportation	159,008			
Community services	4,092			
	<u>\$ 921,199</u>			

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE F – LONG-TERM OBLIGATIONS

The original amount of each issue, the issue date, and interest rates are summarized below:

<u>Issue Date</u>	<u>Proceeds</u>	<u>Rates</u>
1998	\$ 925,000	3.95% - 4.60%
2000	4,900,000	5.25% - 5.62%
2002	4,900,000	1.40% - 4.10%

The District, through the General Fund (including utility taxes and the Support Education Excellence in Kentucky (SEEK) Capital Outlay Fund) is obligated to make payments in amounts sufficient to satisfy debt service requirements on bonds issued by the Russell County School District Finance Corporation to construct school facilities. The District has an option to purchase the property under lease at any time by retiring the bonds then outstanding.

The District has "participation agreements" with the Kentucky School Facilities Construction Commission. The Commission was created by the Kentucky General Assembly for the purpose of assisting local school districts in meeting school construction needs. The table below sets forth the amount to be paid by the District and the Commission for each year until maturity of all bond issues. The liability for the total bond amount remains with the District and, as such, the total principal outstanding has been recorded in the financial statements.

The bonds may be called prior to maturity and redemption premiums are specified in each issue. Assuming no bonds are called prior to scheduled maturity, the minimum obligations of the District, including amounts to be paid by the Commission, at June 30, 2003, for debt service (principal and interest) are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Participation</u>	<u>District's Portion</u>
2003-04	\$ 565,000	\$ 412,278	\$ 305,450	\$ 671,828
2004-05	585,000	397,578	300,901	681,677
2005-06	600,000	381,214	302,557	678,657
2006-07	620,000	362,493	303,138	679,355
2007-08	605,000	342,267	271,485	675,782
2009-13	2,875,000	1,384,247	912,385	3,346,862
2014-18	2,750,000	747,871	520,840	2,977,031
2019-20	<u>1,160,000</u>	<u>98,578</u>	<u>151,615</u>	<u>1,106,963</u>
	<u>\$ 9,760,000</u>	<u>\$ 4,126,526</u>	<u>\$ 3,068,371</u>	<u>\$ 10,818,155</u>

In prior years, the District advance refunded certain bonds. Therefore, those bonds are not listed as a long-term obligation. The outstanding defeased bonds were \$ 1,605,000, at June 30, 2003.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE F – LONG-TERM OBLIGATIONS - CONTINUED

Accumulated Unpaid Sick Leave Benefits

Upon retirement from the school system, an employee will receive from the District an amount equal to 30% of the value of accumulated sick leave.

Sick leave benefits are accrued as a liability using the termination payment method. An accrual for earned sick leave is made to the extent that it is probable that the benefits will result in termination payments. The liability is based on the School District's past experience of making termination payments.

The entire compensated absence liability is reported on the government-wide financial statements.

For governmental fund financial statements the current portion of unpaid accrued sick leave is the amount expected to be paid using expendable available resources. These amounts are recorded in the account "accumulated sick leave payable" in the general fund. The noncurrent portion of the liability is not reported.

Long-term liability for the year ended June 30, 2003, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due Within One Year</u>
Governmental Activities:					
Revenue bonds payable	\$10,335,000	\$	\$575,000	\$ 9,760,000	\$565,000
Accrued sick leave	<u>978,181</u>	<u>100,089</u>	<u>27,297</u>	<u>1,050,973</u>	<u>68,093</u>
Governmental Activities:					
Long-term liabilities	<u>\$11,313,181</u>	<u>\$100,089</u>	<u>\$602,297</u>	<u>\$10,810,973</u>	<u>\$633,093</u>

The debt service fund is primarily responsible for paying the bond obligations through funding from the capital outlay and FSPK funds. The general fund is primarily responsible for paying accrued sick leave.

NOTE G – CAPITAL LEASE PAYABLE

The following is an analysis of the leased property under capital lease by class:

<u>Classes of Property</u>	<u>Book value as of June 30, 2003</u>
Buses	\$ 1,599,935

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE G – CAPITAL LEASE PAYABLE - CONTINUED

The following is a schedule by years of the future minimum lease payments under capital lease together with the present value of the net minimum lease payments as of June 30, 2003:

<u>Year Ending June 30,</u>	<u>Capital Lease Payable</u>
2004	\$ 265,287
2005	256,584
2006	252,607
2007	224,637
2008	222,702
Thereafter	<u>1,581,166</u>
Total minimum lease payments	2,802,983
Less: Amount representing interest	<u>(704,249)</u>
Present Value of Net Minimum Lease Payments	<u>\$ 2,098,734</u>

In April 2003, the District entered into a new lease for four buses for \$235,506.

NOTE H – COMMITMENTS UNDER NONCAPITALIZED LEASES

Commitments under operating lease agreements for office equipment provide the minimum future rental payments as of June 30, 2003 as follows:

Year ending June 30, 2004	<u>\$ 9,248</u>
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Rent expense for the year ended June 30, 2003 was \$9,248.

NOTE I – RETIREMENT PLANS

All the District's eligible employees participate in the Kentucky Teacher's Retirement System (KTRS), a statewide multiple-employer public employee retirement system covering all employees of local school districts within the State of Kentucky. KTRS is a cost sharing public employee retirement system with one exception: all risks and costs are not shared by the District but are the liability of the State of Kentucky. KTRS is funded through state and employee contributions and the District has no legal obligation for paying benefits. As discussed below, the District may be required in certain situations to make limited contributions on behalf of certain employees.

The State of Kentucky contributes 13.105% of the employee's gross earnings except for those District employees being paid from and participating in federally funded programs. During the year, contributions of \$1,208,180 were made by the State of Kentucky and \$143,682 in contributions were passed through the District's federally funded programs. Contributions by the employees are 9.855% of gross earnings and are withheld by the District. Such withholdings totaled \$985,142 during the year and were paid by the District to the State of Kentucky. The District has no other liability under the plan. The District's total payroll for all employees during the year was \$13,639,069, and \$10,315,621 of such amount related to employees covered by the retirement plan.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE I – RETIREMENT PLANS – CONTINUED

Substantially all other employees (classified personnel) are covered under the County Employee's Retirement System (CERS). Funding for the Plan is provided through payroll withholdings of 5% and a District contribution of 6.34% of the employee's total compensation subject to contribution. The District's contribution requirement for CERS for the year ended June 30, 2003 was \$334,232, which consisted of \$184,846 from the District and \$149,386 from the employees. The total covered payroll for CERS during the year was \$2,915,486. Benefits under both plans will vary based on final compensation, years of service and other factors as fully described in the Plan documents.

Additional information and historical trend information can be obtained from the separately issued Teacher Retirement System of Kentucky Comprehensive Annual Financial Report.

Deferred Compensation

The District offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The Plan, available to all employees, permits them to defer a portion of their salary until future years. This deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency. GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, allows entities with little or no administrative involvement who do not perform the investing function for these plans to omit plan assets and related liabilities from their financial statements. The Board therefore does not show these assets and liabilities on this financial statement.

NOTE J – COMMITMENTS

Subsequent to the year ended June 30, 2003, the Board entered into construction contracts for the construction of a new Jamestown Elementary School.

NOTE K - CONTINGENCIES

The District receives funding from Federal, State and Local government agencies and private contributions. These funds are to be used for designated purposes only. For government agency grants, if based upon the grantor's review, the funds are considered not to have been used for the intended purpose, the grantors may request a refund of monies advanced, or refuse to reimburse the District for its disbursements. The amount of such future refunds and unreimbursed disbursements, if any, is not expected to be significant. Continuation of the District's grant programs is predicated upon the grantors' satisfaction that the funds provided are being spent as intended and the grantors' intent to continue their programs.

NOTE L - LITIGATION

The District is subject to various other legal actions in various stages of litigation, the outcome of which is not determinable at this time. Management of the District and its legal counsel do not anticipate that there will be any material effect on the combined financial statements as a result of the cases presently in progress, except as described elsewhere in this report.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE M - INSURANCE AND RELATED ACTIVITIES

The District is exposed to various forms of loss of assets associated with the risks of fire, personal liability, theft, vehicular accidents, errors and omissions, fiduciary responsibility, etc. Each of these risk areas is covered through the purchase of commercial insurance. The District has purchased certain policies, which are retrospectively rated which includes Workers' Compensation insurance.

NOTE N - RISK MANAGEMENT

The District is exposed to various risks of loss related to injuries to employees. To obtain insurance of workers' compensation, errors and omissions, and general liability coverage, the District participates in the Kentucky School Boards Insurance Trust Liability Insurance Fund. The public entity risk pools operate as common risk management and insurance programs for all school district and other tax supported educational agencies of Kentucky who are members of the Kentucky School Boards Association. The District pays an annual premium to each fund for coverage. Contributions to the Workers' Compensation fund are based on premium rates established by such fund in conjunction with the excess insurance carrier, subject to claims experience modifications and a group discount amount. Dividends may be declared, but are not payable until twenty-four (24) months after the expiration of the self-insurance term. The Liability Insurance fund pays insurance premiums of the participating members established by the insurance carrier. The Trust can terminate coverage if it is unable to obtain acceptable excess general liability coverage and for any reason by giving ninety (90) days notice. In the event the Trust terminated coverage, any amount remaining in the Fund (after payment of operational and administrative costs and claims for which coverage was provided) would be returned to the members on a pro rata basis.

The District purchases unemployment insurance through the Kentucky School Boards Insurance Trust Unemployment Compensation Fund; however, risk has not been transferred to such fund. In addition, the District continues to carry commercial insurance for all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE O - DEFICIT OPERATING BALANCES

There are no funds of the District that currently have a deficit fund balance. However, the following funds have operations that resulted in a current year deficit of revenues over expenditures resulting in a corresponding reduction of fund balance:

General Fund	\$	257,772
Technology Fund		81,540
Food Service		31,203

NOTE P - COBRA

Under COBRA, employers are mandated to notify terminated employees of available continuing insurance coverage. Failure to comply with this requirement may put the School District at risk for a substantial loss (contingency).

RUSSELL COUNTY SCHOOL DISTRICT**NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED**

Year Ended June 30, 2003

NOTE Q - TRANSFER OF FUNDS

The following transfers were made during the year:

<u>Type</u>	<u>From Fund</u>	<u>To Fund</u>	<u>Purpose</u>	<u>Amount</u>
Operating	General	Special Revenue	Technology Match	\$ 19,687
Operating	Technology	Special Revenue	Close Fund	81,540
Operating	SEEK Capital Outlay	Debt Service	Debt Service	107,445
Operating	FSPK Fund	Debt Service	Debt Service	547,775

NOTE R – INTERFUND RECEIVABLES AND PAYABLES

Interfund balances at June 30, 2003 consisted of the following individual fund receivables and payables:

	<u>Receivables</u>	<u>Payables</u>
General Fund:		
Construction Fund	\$ 89,371	
Special Revenue Fund	619	
FSPK Fund:		
Construction Fund	106,426	
Special Revenue Fund:		
General Fund		\$ 619
Construction Fund:	106,426	
General Fund		89,371
FSPK Fund		106,426
	<u>\$ 196,416</u>	<u>\$ 196,416</u>

NOTE S – ON-BEHALF PAYMENTS

The District receives on-behalf payments from the State of Kentucky for items including retirement and insurance. The amount received for the fiscal year ended June 30, 2003, was \$2,451,000.

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

Year Ended June 30, 2003

NOTE T – BUILDING LEASE

The District leases a portion of its Learning Center to various entities. The following represents payments to be received.

<u>Year Ending June 30,</u>	<u>Amount to be Received</u>
2004	\$ 47,721
2005	23,871
2006	23,871
2007	<u>23,871</u>
	<u>\$ 119,334</u>

NOTE U – SUBSEQUENT EVENTS

On August 1, 2003, the District issued \$6,355,000 in revenue bonds for construction of a new Jamestown Elementary School.

REQUIRED SUPPLEMENTARY INFORMATION

SUPPLEMENTARY INFORMATION

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

RUSSELL COUNTY SCHOOL DISTRICT

NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Year Ended June 30, 2003

NOTE A – BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Russell County School District and is presented on the accrual basis of accounting for proprietary funds and the modified accrual basis of accounting for governmental funds. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B – FOOD DISTRIBUTION

Nonmonetary assistance is reported in the schedule at the fair value of the commodities disbursed.

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

Section I-Summary of Auditor's Results

Section I-Summary of Auditor's Results

Section II – Financial Statement of Findings

No matters were reported.

Section III – Federal Award Findings and Questioned Costs

No matters were reported.

SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

RUSSELL COUNTY SCHOOL DISTRICT

SCHEDULE OF PRIOR YEAR AUDIT FINDINGS

June 30, 2003

There were no prior year audit findings.

**INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE AND ON INTERNAL
CONTROL OVER FINANCIAL REPORTING
BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Members of the Board of Education
Russell County School District
Jamestown, Kentucky

We have audited the basic financial statements of Russell County School District as of and for the year ended June 30, 2003, and have issued our report thereon dated August 22, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States and the audit requirements prescribed by the Kentucky State Committee for School District Audits in Appendices I, II and III of the Independent Auditor's Contract.

Compliance

As part of obtaining reasonable assurance about whether Russell County School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under Government Auditing Standards or state audit requirements.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Russell County School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting that we have reported to the management of Russell County School District in a separate letter dated August 22, 2003.

This report is intended for the information of members of the Kentucky State Committee for School District Audits, the members of the Board of Education of Russell County School District, the Kentucky Department of Education and management and should not be used by anyone other than these specified parties.

Certified Public Accountants
August 22, 2003

**INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND
INTERNAL CONTROL OVER COMPLIANCE IN
ACCORDANCE WITH OMB CIRCULAR A-133**

Members of the Board of Education
Russell County School District
Jamestown, Kentucky

Compliance

We have audited the compliance of Russell County School District with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2003. Russell County School District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Russell County School District's management. Our responsibility is to express an opinion on Russell County School District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations and the audit requirements prescribed by the Kentucky State Committee for School District Audits in Appendices I, II and III of the Independent Auditor's Contract. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Russell County School District's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Russell County School District's compliance with those requirements.

In our opinion, Russell County School District complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2003.

Internal Control Over Compliance

The management of Russell County School District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Russell County School District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses. In addition, the results of our tests disclosed no instances of noncompliance of specific state statutes or regulations identified in Appendix II of the Independent Auditor's Contract - State Audit Requirements.

This report is intended for the information of members of the Kentucky State Committee for School District Audits, the members of the Board of Education of Russell County School District, the Kentucky Department of Education, management and federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Certified Public Accountants
August 22, 2003

MANAGEMENT LETTER COMMENTS

Members of the Board of Education of
Russell County School District
Jamestown, Kentucky

In planning and performing our audit of the basic financial statements of Russell County School District for the year ended June 30, 2003, we considered the District's internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

However, during our audit we became aware of several matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters. A separate report dated August 22, 2003 contains our report on the District's internal control structure. This letter does not affect our report dated August 22, 2003 on the financial statements of the Russell County School District.

We will review the status of these comments during our next audit engagement. We have already discussed many of these comments and suggestions with various District personnel, and their implementation is currently being reviewed. We will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Certified Public Accountants
August 22, 2003

RUSSELL COUNTY SCHOOL DISTRICT

MANAGEMENT LETTER COMMENTS

June 30, 2003

UNCORRECTED PRIOR YEAR COMMENTS

Bank Accounts

Only bank accounts authorized and approved by the Board should be established under the Board's federal identification number. We noted that several independent organizations have established bank accounts using the Board's federal identification number. These organizations include booster clubs, PTO's and other entities. We recommend that the Board contact these organizations and ensure that the bank accounts are not identified with the Board's federal identification number.

Management Response

The District will contact each entity and present the options for moving the accounts from the Board's identification number.

RUSSELL COUNTY SCHOOL DISTRICT

MANAGEMENT LETTER COMMENTS - CONTINUED

June 30, 2003

CURRENT YEAR COMMENTS

Cross-train Employees

During our audit, we noted that one employee processed payroll for the entire year. Also, no other employees had been trained to process payroll. This could result in the District incurring steep costs and operational disruptions in the event the employee leaves or takes vacation. We recommend that the District cross-train employees to perform other functions, so that every position is appropriately backed-up in the event of an unexpected absence.

Management Response

The District has provided training to another employee and has corrected this issue.

Purchase Orders for Food Service

During our audit, we noted that the food service department does not enter its purchase orders into the MUNIS accounting system. The failure to enter these purchase orders resulted in capital assets not being added to the capital asset subsidiary ledger until after year-end. Also, by not entering purchase orders into MUNIS, it is difficult to determine the department's available budget. We recommend that the food service department enter its purchase orders into the accounting system.

Management Response

The Food Service director has been notified that purchase orders should be entered into the accounting system and will begin entering them as part of the ordering process.

Classified Employee Contracts

KRS 161.011 requires that Districts provide contracts for all classified employees. During our audit we noted that several classified employees did not have contracts in their personnel file for the fiscal year ended June 30, 2003. We recommend that the District ensure that all classified employees have completed contracts.

Management Response

The District will ensure that all classified employees have contracts.

RUSSELL COUNTY SCHOOL DISTRICT

MANAGEMENT LETTER COMMENTS - CONTINUED

June 30, 2003

CURRENT YEAR COMMENTS - CONTINUED

Segregation of Duties in Handling Receipts, Paying Bills and Preparing Bank Reconciliations – School Activity Funds

During our audit, we noted that Russell County High School, Russell County Athletic Fund, Russell County Middle School, Russell Springs Elementary and Salem Elementary did not comply with the segregation of duties requirements for handling receipts, paying bills and preparing bank reconciliations as required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education. Union Chapel Elementary did not comply with the paying bills and preparing bank reconciliations requirements.

Management Response

The District will provide training in November 2003 on the procedures required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Use of Receiving Reports – School Activity Funds

During our audit, we noted that Russell County High School, Russell County Athletic Fund, and Salem Elementary did not use the receiving reports (or their equivalent) as required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Management Response

The District will provide training in November 2003 on the procedures required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Internal Account Budgets – School Activity Funds

During our audit, we noted that Russell County High School and Salem Elementary did not prepare and submit internal account budgets to the Superintendent as required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Management Response

The District will provide training in November 2003 on the procedures required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

RUSSELL COUNTY SCHOOL DISTRICT

MANAGEMENT LETTER COMMENTS - CONTINUED

June 30, 2003

Deposit Ticket Preparation – School Activity Funds

During our audit, we noted that Russell County High School and Russell County Athletic Fund did not list the amount and payer of each check on each deposit ticket as required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Management Response

The District will provide training in November 2003 on the procedures required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Purchase Order Completion – Russell County High School

During our audit, we noted that Russell County High School completes a standard invoice instead of a purchase order as required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education. A standard invoice should only be used when the School does not receive a vendor invoice. In addition, the standard invoice must be signed by the vendor.

Management Response

The District will provide training in November 2003 on the procedures required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Certificate of Deposit – Union Chapel Elementary

During our audit, we noted that Union Chapel Elementary has a certificate of deposit that is not listed on its annual financial report as required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Management Response

The District will provide training in November 2003 on the procedures required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

Monthly Financial Report – Union Chapel Elementary

During our audit, we noted that the March 2003 monthly financial report filed with the Board did not balance. However, the report was signed by the School Treasurer and Principal. We recommend that, prior to submission to the Board, all financial reports are carefully reviewed for accuracy.

Management Response

The District will provide training in November 2003 on the procedures required by *Accounting Procedures for Kentucky School Activity Funds* issued by the Kentucky Department of Education.

State Committee for School District Audits
Members of the Board of Education
Russell County Board of Education
Jamestown, Kentucky

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Russell County School District as of and for the year ended June 30, 2003, which collectively comprise the District's basic financial statements, as listed in the accompanying table of contents, and have issued our report thereon dated August 22, 2003. Professional standards require that we provide you with the following information related to our audit.

Our responsibility under auditing standards generally accepted in the United States of America, the standards applicable to financial statement audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations* and the audit requirements prescribed by the Kentucky State Committee for School District Audits in Appendices I, II and III of the *Independent Auditors' Contract*.

As stated in our engagement letter dated July 1, 2003, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the general purpose financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute, assurance and because we did not perform a detailed examination of all transactions, there is a risk that material errors, fraud or illegal acts may exist and not be detected by us.

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our audit procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the District's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget Circular A-133 Compliance Supplement applicable to each of its major federal programs for the purpose of expressing an opinion on the District's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the District's compliance with those requirements.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the District are described in Note A to the financial statements. The District adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*; and Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*, as of July 1, 2002.. We noted no transactions entered into by the District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Significant Audit Adjustments

For purposes of this letter, professional standards define a significant audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the District's financial reporting process (that is, cause future financial statements to be materially misstated). The audit adjustments, in our judgment, do not indicate matters that could have a significant effect on the District's financial reporting process. In addition, management has made all adjustments proposed by us.

Disagreements With Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. There have been no disagreements during the course of our audit.

Consultations With Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters. If a consultation involves application of an accounting principle to the

District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to contact us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditor. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

This report is intended solely for the use of the members of the Board of Education, Kentucky State Committee for School District Audits and management and is not intended and should not be used by anyone other than these specified parties.

Certified Public Accountants
August 22, 2003